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SUBJECT: THE CALDERON ECONOMIC PROGRAM

Sensitive but unclassified, entire text.

Summary  
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¶1. (SBU) Senior staffers Ernesto Cordero and Carlos Montano confidently described National Action Party (PAN) presidential candidate Felipe Calderon's economic platform the week national polls showed Calderon capturing the lead from Party of the Democrat Revolution (PRD) candidate Andres Manuel Lopez Obrador (AMLO). While the candidate has begun repeating the "jobs" mantra in campaign appearances, Cordero and Montano explained that the jobs will come from improved foreign and domestic investment which will be spurred by : passing needed structural reforms; emphasizing rule-of-law improvements; maintaining macroeconomic stability; improving regional development efforts; and making selected additional social expenditures. End summary.

¶2. (SBU) Econoff met with Ernesto Cordero, Chief of Staff for PAN Candidate Felipe Calderon and Carlos Montano, a longtime Calderon staffer, newly resigned from his Director General position at the Secretariat of Energy shortly following last week's release of polls showing the PAN candidate opening up a lead on PRD frontrunner Lopez Obrador.

¶3. (SBU) Both campaigners opened discussions with a quick review of the leading polls which showed their candidates leading by between one and ten points. Cordero was cautiously optimistic. He called the result a "positive" trend. Montano added that the Calderon campaign's decision to run adds drawing parallels between AMLO and Chavez and calling the PRD candidate a danger to Mexico, combined with AMLO's decision not to participate in the first debate, had raised sufficient questions in voters minds so that a large pool of undecided voters had swung, perhaps only temporarily, towards Calderon. Montano hoped aloud that Lopez Obrador would be unable to mount a new message to recapture the momentum; while at the same time he outlined the "new" Calderon message that focused on job creation. The one-word message that the candidate would repeat would not be investment, but rather "jobs." Both aides added that the key to job creation would be to reverse Mexico's slide in worldwide rankings as recipient for inward investment. Montano pointed to AT Kearney's 2004 FDI confidence index, which saw Mexico drop from third to twenty-second place globally as a FDI destination as an example of the crisis.

¶4. (SBU) The staffers outlined a five pillar program to increase both domestic and foreign private investment: pass

needed structural reforms, emphasize rule-of-law improvements, maintain macroeconomic stability, improve regional development efforts, and make selected additional social expenditures.

#### Structural Reforms First -- Fiscal, Energy, and Labor

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15. (SBU) Despite the broad script from which they were working, the staffers concentrated primarily on structural reforms as the most effective way to spur inward investment. Montano said it would be the first order of business for "President Calderon." While pundits frequently provide a laundry list of essential Mexican reforms, Montano noted that the initial proposal of a Calderon administration would focus simultaneously on three -- energy, labor, and fiscal reform -- as a first step. Montano said that the three areas were so closely related as to make it difficult to consider proposals separately.

16. (SBU) On energy, significant Mexican growth would be impossible without energy supplies at competitive prices. The PAN team understood and assumed that without additional development, Mexican crude production would begin to fall in the short term. Deep-water development, Cordero said, would be essential to maintaining Mexican production. Calderon would reintroduce a version of this legislative session's failed corporate governance proposals that diluted or eliminated the weight of the unions on Pemex's governing board and further simplified and reduced Pemex's payments to Hacienda. Additionally, Calderon would also strengthen the role of the Energy Regulatory Commission (CRE).

17. (SBU) Beyond the initial reforms, Cordero, a former

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Hydrocarbon Undersecretary under Calderon at the Secretariat of Energy, added that Calderon believed that "complementary investment" in the hydrocarbon sector would enable Pemex to seek out foreign investors to build a refinery without first changing the Mexican constitution, though considerable legislative involvement would be necessary.

18. (SBU) On electricity, more liberalization would enable more attractive agreements with private producers. Montano added that additional cross border connections with the U.S. should allow CFE to provide electricity in Texas, where, in many cases, CFE would be the lower cost producer, while making additional, lower cost power available to some Mexican consumers.

19. (SBU) Concurrent with energy reform, Calderon notes that Mexican income tax evasion rates among the self-employed reach 77 percent and VAT evasion is 39 percent. Given its evasion and tax rate, Mexico is able to capture less than five percent of its GDP for government coffers. Nonetheless, at 30 percent, Mexico's corporate tax rate is much higher than its competition -- China at 15 percent and Chile at 17 percent. To improve collection while making Mexico more competitive, Calderon proposes a single simplified rate, minimizing deductions, but improving collections.

110. (SBU) The Calderon team proposes addressing Mexico's rigid labor laws by relaxing work rules to increase opportunities for women and the young making part-time work more feasible and allowing for apprenticeships and paid training.

#### Rule of Law Next

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111. (SBU) Beyond these structural reforms, both Montano and Cordero listed rule of law at the second most important investment impediment the candidate would tackle. While the candidate has an extensive series of proposals to reduce corruption and strengthen law enforcement, Montano boiled

down the proposals saying that Calderon would improve police pay and provide them with necessary equipment. He also spoke enthusiastically about instituting information technology tools and databases that would aid police work.

#### Maintaining Macro Stability

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¶12. (SBU) While both staffers were quick to praise the Fox administration for the stability and strength of the peso, they did note that any incoming president would have to work to maintain it. While any Mexican president will be able to appoint four of five central bank governors, the terms are staggered, ending in the first, third, fourth, and fifth year of the presidency, so that sudden change will not be possible. Still, Montano noted the close working relationship between Hacienda Secretary Gil Diaz and Central Bank Governor Ortiz and noted that such a relationship would continue in a Calderon Presidency.

#### Regional Development

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¶13. (SBU) On regional development, Montano and Cordero both pointed to improvement of basic infrastructure and tourism as an engine for development. Cordero noted Calderon would stop short of recommending specific projects for particular areas, adding that it would be economically inefficient for the government to pick winners. In more general terms, Cordero noted that Mexico was particularly poor in transverse routes crossing mountain ranges. The candidate generally supported rail and airport improvement as well, but the lead for these developments would need to come from the private sector.

#### Social Expenditure

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¶14. (SBU) Social expenditure, the final pillar of the Calderon program, would concentrate on three areas at first: health, education, and housing. The key feature of Calderon's health package would combine federal, state, and private entities to create universal health coverage for Mexicans. Recognizing Mexico's position of 30 out of 31 OECD member countries in education, Calderon also proposes

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improving the educational system with an extensive list of reforms, including extending school hours and requiring testing. On housing, Calderon would continue the Fox administration's housing policies.

#### Other Issues

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¶15. (SBU) Besides these broad campaign themes, we asked Cordero and Montano how they would confront other issues of concern to the U.S. While the candidate and his staff had not defined specific proposals, on agriculture, Montano understood the pressures that 2008 NAFTA opening would bring. Nonetheless, he agreed that keeping the U.S.-Mexican border closed to corn and bean imports would not do a great deal to alleviate the problems of the subsistence farmer. Montano admitted that he and other staffers had recently discussed developing a policy for Calderon to confront Mexican monopolists as a way to improve economic competitiveness, but was not optimistic about such a proposal going much further in the campaign. Montano was also quick to dismiss Fox's Mesoamerican energy plan, noting that Mexico needed foreign investment to build its own refineries.

#### Comment

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¶16. (SBU) Cordero and Montano as well as the other Ivy

league-trained members of Calderon's staff understand and truly believe the liberal economic model will be the springboard to Mexican economic success. Nonetheless, they remain realistic about the strength and pervasiveness of entrenched interests from Mexican monopolists to the unions. They are outwardly convinced that their candidate has the political skill to succeed at forging consensus between the parties where President Fox has failed. Following his heart-felt defense of the Calderon economic program, Montano, who had recently resigned from his USD 200 thousand plus per year Director General job at the Secretariat of Energy, confided that despite the excitement of the campaign, there were nights he worried so much about the election results, he could not sleep.

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